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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

ROBERT D. FISH, Cross-complainant and Appellant, v. RUTAN & TUCKER LLP, Cross-defendant and Respondent.	G042057 (Super. Ct. No. 07CC07941) O P I N I O N

Appeal from a judgment of the Superior Court of Orange County, William M. Monroe, Judge. Affirmed.

Chamberlin Keaster & Brockman, Robert W. Keaster, and Michael A. Miller for Cross-complainant and Appellant.

Jasper & Jasper, Stuart P. Jasper for Cross-defendant and Respondent.

* * *

Who must pay for the defense of a lawsuit alleging breach of fiduciary duty, fraud, and malpractice against an attorney and his former law firm (which self insured against the first $500,000 of any professional liability claim and defense thereof)? Here, the trial court found: (1) appellant Robert D. Fish (Fish), a former partner at respondent Rutan and Tucker LLP (Rutan), was not entitled to indemnification from Rutan for Fish's defense costs; and (2) Fish was obligated to indemnify Rutan for its defense costs. There is substantial evidence supporting the court's factual finding that Fish engaged in willful misconduct in connection with the claims, thereby obligating Fish under the Rutan partnership agreement to indemnify Rutan. We affirm the judgment.

FACTS

Background

Fish joined Rutan as a "contract" partner in 2002. A letter agreement between Fish and Rutan indicated Fish's "rights and obligations would be the same as the rights and obligations of regular equity partners of the firm (as set forth in the firm's Amended and Restated Partnership Agreement, including all amendments approved prior to the date of this letter and any subsequent amendments applicable to partners generally, of which none are in the process at this time), except as expressly set forth in this letter." The letter agreement further indicated Fish would become an equity partner of the firm as of January 1, 2003 if not terminated prior to that date. On March 20, 2007, Fish withdrew from Rutan. Rutan accepted Fish's resignation and waived the 30-day notice period designated in the partnership agreement.

The dispute in this case arose out of the representation of a client by Rutan and Fish while Fish was still a Rutan partner. In the spring of 2004, Alexander Bobarykin retained Rutan to represent VIP Technologies, Inc. (VIP), a company owned by Bobarykin and Viktor Petrik. Bobarykin sought Rutan's assistance in preparing a

patent application for a water purification device developed by VIP. Prior to retaining Rutan, Bobarykin met separately with Fish (a patent attorney) and Martin Fessenmaier (a patent agent who worked with Fish).

Bobarykin informed Fish he did not have significant capital; in fact, Bobarykin noted he and Petrik owed a debt in Russia. Fish responded that after the creation of a California entity, Fish and Fessenmaier would develop the patent application and attract investors. Bobarykin asked Fish if Rutan could work on credit or accept shares in the new entity in exchange for patent work. Fish said no. Fish said instead that he and Fessenmaier would continue to work on the patent applications, but would charge less than cost (by, for instance, only charging for one out of 10 hours of work). Fish indicated that, in the future, the new entity could then allocate equity interests (five percent each) to Fish and Fessenmaier. Fish noted he was not interested in staying at Rutan for very long; Fish indicated he would leave Rutan to work for the new entity once it succeeded.

Pursuant to Fish's recommendation, a Rutan corporate attorney assisted in the formation of SupraCarbonic, LLC. The members of SupraCarbonic were Bobarykin and Petrik, each with 50 percent interests in SupraCarbonic. The SupraCarbonic operating agreement, entered into as of June 2004, provided: "The Company has initially selected the firm of Rutan & Tucker, LLP ('Company Counsel') as legal counsel to the Company. . . . Each Member acknowledges that Company Counsel does not represent any other Member unless there exists a clear and explicit agreement to such effect between the Member and Company Counsel, and that in the absence of any such written agreement Company Counsel shall owe no duties directly to any other Member."

In November 2004, Fish called Bobarykin into Fish's office and shut the door. Fish told Bobarykin there was a substantial bill owed by SupraCarbonic to Rutan. Fish offered to lend Bobarykin $100,000; Fish handed Bobarykin the check and asked that Bobarykin sign a written agreement that Fish printed off his computer. Fish told

Bobarykin to pay $80,000 to Rutan for legal bills and to keep $20,000 for SupraCarbonic expenses. Bobarykin and Fish signed the agreement. The agreement granted a security interest to Fish in Bobarykin's ownership interest in SupraCarbonic. Bobarykin covenanted not to engage in any of a series of actions with regard to SupraCarbonic without the prior written consent of Fish (e.g., grant any other security interests in SupraCarbonic, change the financial structure of SupraCarbonic, or enter into any transactions outside the ordinary course of business).

Two similar transactions occurred in January 2005 ($60,000) and March 2005 ($50,000). The final, March 2005, "secured loan agreement" purported to supersede and consolidate the three loans into a single $210,000 loan. This agreement, like the previous two agreements, granted Fish a security interest in Bobarykin's ownership interest in SupraCarbonic and included various restrictive covenants to protect the lender's (Fish's) interests. On the advice of a business associate, Bobarykin consulted an attorney not affiliated with Rutan in approximately February 2005. This attorney reviewed at least some of the secured loan agreements, but it does not appear any substantive changes were made in the third secured loan agreement. The interest rate charged on the loan was 1 percent per month.

In a March 21, 2005 e-mail (to a potential investor), Fish wrote: "So far I have been funding the company, indirectly through loans to Alex [Bobarykin]. I expect to have about $250k invested within a few weeks. Most of that money has gone into testing and bringing in about 2000# of product, marketing, patenting, etc." In an August 17, 2006 e-mail, Fish wrote to a recipient whose name is redacted: "I would like to invest $50K, but I just can't do anything until I get back some of the funds from my main investment in SupraCarbonic. I have no confidence that such will occur in the near future." On November 20, 2006, Fish wrote an e-mail to Bobarykin objecting to a proposed action: "Alex, would you please call me? Those applications are used as collateral on the loan, and cannot be transferred until the loan is paid off."

During a meeting with a potential investor, Fish (after asking Bobarykin to leave the room so Fish could discuss the deal alone with the potential investor) proposed: "Alex, here we were able to come to an agreement as follows: We are going to create a mutual entity, joint venture, between A.I.C. and SupraCarbonic, 49 and 49. I'm going to have two percent just in case, if you will have different opinions, so I will be the one to break the tie." A document attached to a 2007 e-mail, which was drafted by a potential investor, confirms Bobarykin's testimony about a proposed 2 percent ownership stake to Fish. An e-mail string from February and March 2007 involving Fish, Fessenmaier, and the potential investors indicates the deal was not consummated.

The parties stipulated to the following facts: "[25:] Neither Mr. Fish nor Rutan & Tucker ever provided any written disclosures of actual conflicts of interest to either SupraCarbonic, L.L.C., or Mr. Bobarykin regarding the documents entitled [']secured loan agreement[']. It is disputed between the parties as to whether such written disclosures were required by law[;] [¶] 26: Neither Mr. Fish nor Rutan & Tucker ever provided any written disclosure to Mr. Bobarykin of the right to consult independent counsel concerning the documents entitled, secured loan. It is disputed between the parties as to whether such written disclosures were required by law. [¶] . . . 27: Mr. Fish never disclosed to Rutan & Tucker management any of the loans to Alex Bobarykin or that the funds were being used to pay Rutan & Tucker's fees."

In his testimony, Fish had a number of explanations for the reasons why nothing he did was objectionable. Fish testified he thought he only needed to disclose to Rutan "equity" investments in clients rather than loans. Fish testified "[t]he entire security interest was void ab initio by terms of the operating agreement." Fish testified he did not take a security interest in a client because he "could not have foreclosed on the security interest because it was void." Fish conceded he did not intend for his security interests in SupraCarbonic to be void at the time he executed the secured loan

agreements, but insisted he "had absolutely no intention at any time . . . of ever foreclosing" on that interest.

Fish testified he asked the executive committee if it were appropriate or an ethical violation to (in general) "lend money to a principal of a client." Fish claims he received a response that there was no problem with this idea and that "there was no need to know any further details." But the managing partner of Rutan denied receipt of such an inquiry, explaining: he has no recollection of receiving such an inquiry, a search of his electronic files discloses no such inquiry, and if such an inquiry had been received, "[t]he matter would be placed on the agenda for our next executive committee meeting, and at that meeting we would then determine generally whether to allow the loan or to allow the investment." The managing partner searched the minutes of past executive committee meetings and found no mention of an inquiry by Fish.

In December 2005, Fish sent an e-mail to the corporate partner who prepared SupraCarbonic's operating agreement. He inquired: "Alex Bobarykin wants to obtain a personal loan, using his membership interest in SupraCarbonic as security. An attorney for Bobarykin stated that the following paragraph violates Supra's operating agreement. Would you please tell me whether it does or not?" Fish then quoted the language from the secured loan agreements he drafted granting himself a security interest in SupraCarbonic. Fish told his partner in a follow up inquiry the language was "from a proposed loan." Fish never disclosed in the e-mail exchange that he had provided loans to Bobarykin. As previously noted, Fish left Rutan in March 2007. Fish began practicing at his own firm immediately thereafter in Irvine, California.

Procedural History

A few months after leaving Rutan, Fish filed a complaint against Bobarykin, alleging breach of contract (the three written loan agreements), fraud in the inducement, and conspiracy. Fish sought $210,000 in damages based on the loan

agreements, plus interest and attorney fees. Fish attached each of the loan agreements to the complaint, alleged he entered the contracts with Bobarykin, and verified the complaint.

Counsel for Bobarykin, Robert Sall, first responded to the complaint with a letter accusing Fish of professional misconduct in association with Fish's representation of SupraCarbonic and Fish's loans to Bobarykin. Sall provided Rutan partner John Hurlbut with a copy of this letter. Hurlbut promptly demanded that Fish indemnify Rutan for all claims arising out of the matters referenced in the Sall letter; Hurlbut recommended that Fish dismiss his lawsuit as requested by Sall.

When Fish did not dismiss his suit as requested by Sall and Hurlbut, Bobarykin and SupraCarbonic filed a cross-complaint against Fish and Rutan for breach of fiduciary duty, fraud, and legal malpractice.

Rutan responded with a cross-complaint for indemnity (contractual and equitable) against Fish, alleging: "As a term and condition of the partnership agreement, Fish agreed to indemnify and hold Rutan harmless from any and all loss, claims, expenses and liability that Rutan might incur at any time as a consequence of any acts or omissions by Fish arising from his practice of law with Rutan."

Not to be outdone, Fish filed a cross-complaint for breach of insurance contract and indemnity (contractual and equitable) against Rutan. Fish alleged Rutan had the obligation to pay for claims against Fish by Bobarykin and SupraCarbonic pursuant to the partnership agreement and the professional liability policy maintained by Rutan.

Bobarykin and SupraCarbonic settled with Rutan; the terms of this settlement apparently consisted of a dismissal with prejudice of the claims against Rutan without any monetary payments. Bobarykin and SupraCarbonic also settled with Fish in November 2008. The written settlement agreement indicates Bobarykin promised to pay Fish $40,000 over two years; the parties released each other from all claims. Fish and Rutan proceeded to trial to determine who should indemnify whom for the attorney fees

incurred by each party in defending the lawsuit brought by Bobarykin and SupraCarbonic.

Insurance

Rutan, the "Named Insured," maintained a "Lawyers Professional Liability Insurance Policy" at all relevant times. In the "DEFINITIONS" section of the policy, "'Insured'" is defined to include both Rutan and "any person or professional corporation who is or becomes a Partner . . . of the Named Insured but solely while acting within the scope of his duties on behalf of the Named Insured." The policy includes a "self-insured retention" of $500,000. "The [insurer's] obligation to pay Damages and Defense Fees applies in excess of the Self-Insured Retention stated in the Declarations. The Insured shall pay all Damages and Defense Fees up to the amount of the Self-Insured Retention. The Self-Insured Retention applies separately to each Claim." It does not appear that the $500,000 threshold was reached in this case, even if the defense costs of both Rutan and Fish are combined.

The insurer notified Rutan partner John Hurlbut that it had conducted an investigation based on documents provided and determined it would continue to investigate and evaluate the matter. The insurer reserved its right to deny coverage. In its reservation of rights, the insurer specifically highlighted a policy exclusion precluding coverage for "any judgment or final adjudication based upon or arising out of any dishonest, deliberately fraudulent, criminal, maliciously or deliberately wrongful Acts committed by or at the direction of, or ratified by, an Insured."

Partnership Agreement

The Rutan partnership agreement (including the 1991 Amended and Restated Partnership Agreement and various amendments) sets forth the respective rights and obligations of Rutan and its individual partners. As one might expect, the partnership

agreement is both lengthy (102 pages are included in the record) and complex. As noted in the Recitals, "Each party to this Partnership Agreement, and each additional party who in the future becomes a party to this Partnership Agreement, and whose status as a partner of the Partnership has not terminated, may be referred to herein as a 'Partner,' and all of such parties may be collectively referred to herein as the 'Partners.'" Fish was a Rutan "Partner" from 2002 to 2007.

Several provisions in the partnership agreement pertain to rights of indemnity. The partnership agreement contemplates indemnity in both directions — sometimes Rutan will indemnify individual partners, sometimes individual partners will indemnify Rutan.

The precise language of the relevant indemnity provisions in the partnership agreement will be recited in the discussion that follows. As a preview, however, we paraphrase here the indemnity provisions we considered in our analysis.

- Section 9.7 requires any partner who violates the partnership agreement, or the rules and regulations of the partnership, to defend and indemnify Rutan against any liability that arises from the violation.
- Section 10.7(a) requires Rutan to indemnify any terminated or retired partner against any liability of the partnership unless the liability results from the negligence, willful misconduct, or other wrongful act of the partner.
- Section 10.7(c) requires any terminated or retired partner to indemnify Rutan for all expense and liability resulting from the negligence, willful misconduct, or other wrongful act of the terminated or retired partner.

We note that both section 9.7 and section 10.7 were included in the 1991 Amended and Restated Partnership Agreement. Rutan amended the partnership agreement in 1997 to further address indemnity concerns by adding section 9.8, without deleting section 9.7 and 10.7. We paraphrase here the several subdivisions of the added section 9.8.

- Section 9.8(a) requires Rutan to defend and indemnify any "Covered Partner" against all expenses and liability arising from any "Covered Act."

- Section 9.8(b) defines "Covered Partners" as the equity partners of the firm on March 8, 1997 and equity partners admitted to the partnership after that date. But any equity partner who is expelled from the partnership for cause is excluded from the definition of a "Covered Partner." And, unless Rutan's Executive Committee determines otherwise, a former partner who has left the partnership prior to the final resolution of a "Covered Act," and who continues to practice law within a 100-mile radius of Rutan's address in Costa Mesa within two years of the withdrawal, is also excluded from the definition of a "Covered Partner."

- Section 9.8(c) defines "Covered Acts," inter alia, as those acts or omissions committed in the provision of professional services and in the course and scope of the partners performance as a partner of the firm, and other acts or omissions not in the performance of professional services on behalf of the partnership but which have been authorized in writing by Rutan's executive committee. Upon the good faith determination of the executive committee that a "Covered Partner" was not acting within the course and scope of his or her performance as a partner, or that the subject act or omission constituted willful misconduct or a material violation of the partnership agreement or adopted firm policy, the subject act or omission is not to be considered a "Covered Act."

- Section 9.8(d) provides that if a third party claim is made jointly against Rutan and a "Covered Partner" for a "Covered Act," Rutan waives and releases any claim for contribution or indemnity against the "Covered Partner."

Rutan Personnel Policies

Section 13 of the partnership agreement pertains to "Firm Opportunities":

"13.1 Executive Committee Approval of Direct Payments. No salaries, commissions,

fees or gratuities of any substantial significance shall be accepted, directly or indirectly, by any Partner personally from any client or prospective client of the firm, unless with the express consent in advance of the Executive Committee . . . ." "13.3 Firm Opportunities. Without the prior approval of the Executive Committee no Partner shall (i) make an investment in a client, (ii) make an investment in any other party by reason of the rendition of legal services by the firm . . . ."

As is customary and prudent, Rutan maintains written personnel policies for all attorneys. Such rules and regulations are authorized by section 7.2 of the partnership agreement. Section 3.1 of Rutan's "General Personnel Policies," in force at the time of Fish's stint at Rutan, indicates "It is each attorney's responsibility to be familiar with and to adhere at all times to the Rules of Professional Responsibility and all canons of ethics governing the legal profession and the practice of law. This responsibility is never to be compromised based upon considerations of personal convenience, perceived financial reward (to the firm or attorney), or otherwise."

Section 4.16 of the "General Personnel Policies" provides: "In the event that any attorney wishes to invest in or with a client . . . he or she should notify the Executive Committee in writing, which writing should describe the investment." "If the Executive Committee determines that an attorney should be allowed to make the investment, the attorney should be aware of and comply with Rule 3-300 of the California Rules of Professional Conduct. That rule provides as follows: [¶] 'A member shall not enter into a business transaction with a client; or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied: [¶] (A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and [¶] (B) The client is advised in writing that the client may seek the advice of an Independent attorney of the client's choice and is given a

reasonable opportunity to seek that advice; and [¶] (C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.'"

Ruling

The court orally announced its statement of decision under Code of Civil Procedure section 632. The court found Rutan to be the prevailing party on both its cross-complaint and on Fish's cross-complaint. The statement of decision is lengthy, and mixes the court's findings with discussion of the evidence and arguments presented. But, among other findings, it is clear the court ruled as follows: "I find the conduct of Mr. Fish not something negligent, but something willful. And [Fish's] wrongful acts . . . took him outside of the protections of Covered Partner and Covered Acts. [¶] Was there a breach of fiduciary duty? Yes. By Mr. Fish, yes." The court added: "Fish's acts and omissions constituted willful misconduct or other wrongful acts within partnership agreement 10.7, [(c)]." The court, applying Evidence Code section 780, noted throughout its description of Fish's testimony that Fish lacked credibility.

As part of its oral statement of decision, the court explicitly adopted all of Rutan's proposed findings of fact (other than striking the word "negligence"), which were set forth in a trial brief submitted to the court. In doing so, the court made clear it found "1. In connection with representation of [SupraCarbonic] and his entering into [secured loan agreements] with [Bobarykin], Fish violated [Rules of Professional Conduct], Rule 3-300, Rule 3-310(B)(1), (3) and (4), Rule 3-310(C)(1) and (2), and Rule 3-500. Fish did not obtain [SupraCarbonic's] informed consent to the [secured loan agreements]. The [secured loan agreements] constituted security interests or other pecuniary interests adverse to [SupraCarbonic]. Fish improperly used and disclosed to AIC confidential information belonging to [SupraCarbonic] in his simultaneous representation of AIC and [SupraCarbonic]. There were both potential and actual conflicts of interest between Fish's clients AIC and [SupraCarbonic]. Fish violated State

Bar Act, Bus. & Prof. C. sec. 6068(e)(1) as to confidentiality. [¶] 2. Fish initiated the litigation by suing Bobarykin. Fish's suit caused Bobarykin and [SupraCarbonic] to file a cross complaint against Fish and Rutan . . . . Fish's breaches of the [Rules of Professional Conduct] and related ethical principles were the gravamen of the cross complaint by Bobarykin and [SupraCarbonic]."

"3. Fish violated the [partnership agreement] and his fiduciary duty of loyalty and good faith and fair dealing to Rutan by not disclosing to Rutan's Executive Committee his proposed and completed business opportunities with [Bobarykin] and [SupraCarbonic], including the [secured loan agreements] and surrounding circumstances and Fish's stated intention to take an ownership interest in [SupraCarbonic] in the future. This violated sec. 13.3 of the [partnership agreement]. It also violated the [Rutan written personnel policies]. These acts and omissions triggered indemnity in favor of Rutan under Sec. 9.7 of the [partnership agreement]."

"5. Fish's acts and omissions constituted . . . wilful misconduct, or other wrongful acts within [partnership agreement section] 10.7(c), trigg[erring] Fish's duty of indemnity. [Citation.] There is some evidence of actual malice by Fish toward Rutan. [Bobarykin] testified, and Fish did not deny, that Fish told [Bobarykin] in early 2007, before Fish left Rutan, that [Bobarykin] *should not* pay Rutan's bill of over $100,000."

"7. Rutan is entitled to indemnity from Fish for its costs of defense of the [Bobarykin/SupraCarbonic] cross-complaint under secs. 9.7 and 10.7(c) of the [partnership agreement, including the [Rutan written personnel policies], which constituted the rules and regulations. [Citations.] Rutan incurred costs of defense reasonably and in good faith, subject to judicial review of the invoices."

The court also found the provision, in section 9.8(b) of the partnership agreement, relating to the exclusion from the definition of "Covered Partner" of former partners practicing within 100 miles of Costa Mesa to be "reasonable under the circumstances." The adopted written finding of fact on this issue provides: "6. Fish

failed to carry his burden of proof under [Business & Professions Code section] 16602 that the toll on departing partners was unreasonable. Pursuant to [Civil Code section] 1671, the toll was a reasonable tax on competition. The anticipated disadvantages to the firm, as of Fish's becoming a partner, were the following: (1) loss to the partnership of accounts receivable; (2) loss of clients going with the departing partner; (3) loss of a specialty law practice that would harm the firm's ability to be a full service firm; (4) costs of hiring a headhunter; (5) paying staff who did not leave with the departing partner but had little work to do; (6) increase in each partner's share of overhead; and (7) having to pay for malpractice defense costs up to the $500,000 Self-Insured Retention . . . even though the party who caused the claims would no longer be with the firm and would no longer be contributing to the firm. Projected anticipated savings to the firm were not having to pay the [self-insured retention]. Projected advantages to the departing partner were taking clients, using Rutan's affiliation as an imprimatur of approval, and being able to compete with Rutan. Under the rule of reason, the toll was not unreasonable. [Citation.] Fish earned substantially more by leaving Rutan to start up his own practice, and the increase more than compensated Fish for giving up, as the toll on competition, the [self-insured retention] for defense of malpractice cases which arose from alleged acts or omissions by Fish. (There were two such cases.) Fish's alleged attorney fees were $200,000. Thus Fish was not a 'Covered Partner' for purposes of Sec. 9.8 of the [partnership agreement], and Rutan owes no duty of indemnity to Fish thereunder."

The court entered judgment in favor of Rutan and against Fish in the amount of $236,960.

DISCUSSION

We interpret the meaning of a contract de novo, unless extrinsic evidence is admitted to determine the meaning of ambiguous provisions, in which case credibility

determinations are evaluated under the substantial evidence test. (*California National Bank v. Woodbridge Plaza LLC* (2008) 164 Cal.App.4th 137, 142.) We review the court's factual findings under the deferential substantial evidence standard. (*ASP Properties Group, L.P. v. Fard, Inc.* (2005) 133 Cal.App.4th 1257, 1266.)

"In general, [an indemnity] agreement is construed under the same rules as govern the interpretation of other contracts. Effect is to be given to the parties' mutual intent [citation], as ascertained from the contract's language if it is clear and explicit [citation]. Unless the parties have indicated a special meaning, the contract's words are to be understood in their ordinary and popular sense." (*Crawford v. Weather Shield Mfg., Inc.* (2008) 44 Cal.4th 541, 552.) "In the interpretation of a contract of indemnity, the following rules are to be applied, unless a contrary intention appears: [¶] . . . [¶] 4. The person indemnifying is bound, on request of the person indemnified, to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity, but the person indemnified has the right to conduct such defenses, if he chooses to do so; [¶] 5. If, after request, the person indemnifying neglects to defend the person indemnified, a recovery against the latter suffered by him in good faith, is conclusive in his favor against the former . . . ." (Civ. Code, § 2778.)

But the partnership agreement at issue here is different from many indemnity agreements in that it provides for mutual indemnity. In some situations, Rutan will indemnify individual partners; in other circumstances, individual partners will indemnify Rutan. Thus it is unhelpful for either side to point to the other's "duty to defend" under the partnership agreement before resolving the foundational dispute of who must indemnify whom in this case.

The bulk of the parties' briefs pertain to the question of whether section 9.8(b) of the partnership agreement — by excluding from the definition of "Covered Partner" partners competing within Rutan within 100 miles after terminating their association with Rutan — is a reasonable "toll" or an unenforceable restraint on trade.

(See *Howard v. Babcock* (1993) 6 Cal.4th 409, 412 (*Howard*) [holding "an agreement among law partners imposing a reasonable toll on departing partners who compete with the firm is enforceable"].) It is certainly true that *one* basis for part of the judgment (the part in which Rutan is not obligated to indemnify Fish) was the court's finding that section 9.8(b) included an enforceable, reasonable "toll" on terminated partners who competed with Rutan within 100 miles. But this analysis does not support a conclusion that Fish was obligated to indemnify Rutan.

Fish's Misconduct Precludes Indemnity in His Favor and Results in Indemnity of Rutan

In our view, the parties have glossed over a simpler basis for affirming the judgment. There is substantial evidence in the record supporting the court's detailed findings with regard to Fish's willful professional misconduct and violations of the partnership agreement and firm policies while representing VIP/SupraCarbonic. Given those findings: (1) Fish was obligated under the partnership agreement to indemnify Rutan for its costs of defending the Bobarykin/SupraCarbonic lawsuit; and (2) Rutan was not obligated under the partnership agreement to indemnity Fish for his costs of defending the Bobarykin/SupraCarbonic lawsuit.

Extracting the essence of the court's ruling from the lengthy oral statement of decision is somewhat difficult. The court was more articulate earlier in the trial when it rejected Fish's motion to bifurcate the trial to concentrate solely on the question of whether the "toll" provision was enforceable: "See, the court believes that even if Mr. Fish was a Covered Partner, his acts were precluded. And from what little I [have observed] so far, it does not sound like his conduct was a Covered Act. And so we have two things; Covered Partner and Covered Act. So when all is said and done, the court does not believe that bifurcating this lawsuit will make it any more expeditious or any more clear." In other words, at trial and on appeal, Fish has attempted to focus

exclusively on the enforceability of the "toll" provision while ignoring the question of whether Fish's misconduct excused Rutan from indemnifying Fish.

Despite the contract's length and complexity, it is plain that Fish is responsible for his own defense costs and for those of Rutan.

Section 9.7 of the partnership agreement provides: "Any Partner who shall violate any of the terms, covenants or conditions of this Agreement or of the rules and regulations of the Partnership . . . shall protect, hold harmless and indemnify the Partnership and each Partner thereof, against any and all claims, costs, expenses, demands, actions or liabilities that may arise out of or by reason of such violation. Further, upon demand, any Partner who shall violate [as specified above] shall be obligated to assume the defense of the Partnership . . . and shall pay all costs and provide all necessary legal counsel for the Partnership, and for each of the other Partners, from the initiation through the final conclusion of any special proceeding, action, or arbitration instituted against the Partnership . . . ." Fish violated the partnership agreement and the rules and regulations of Rutan when he secretly invested in SupraCarbonic without informing the partnership. Fish also violated various rules of professional conduct by, among other things, taking a security interest in a client and failing to make appropriate written disclosures to Bobarykin. (See Rules of Prof. Conduct, rules 3-300, 3-310.)[1]

Section 10.7(c) reiterates the same basic idea with regard to "terminated" partners: "Any terminated or retired Partner . . . shall indemnify and hold the Partnership and all of the remaining Partners harmless from all expenses, claims, demands, liabilities and/or obligations of the Partnership resulting from the negligence, wilful misconduct or other wrongful acts of the terminated, retired, or deceased Partner, including without

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[1] Fish protests that Bobarykin was not actually his client. But Bobarykin was a 50 percent owner of SupraCarbonic and the human representative of SupraCarbonic called into Fish's office to answer for SupraCarbonic's attorney fees by signing "secured loan agreements" with Fish.

limitation any act which the Partnership's professional liability insurance carrier excepts from coverage or for which such carrier reserves the right of subrogation against an insured and also including without limitation reasonable attorneys' fees and costs, except to the extent such claim, demand, liability and/or obligation is paid by insurance carried by the Partnership, without a reserved right of subrogation." Rutan's attorney fees and costs arose out of Fish's willful misconduct and wrongful acts.

Section 10.7(a) of the partnership agreement precludes indemnity for terminated partners "from and against any liability of the Partnership" when "such liability shall result from the negligence, willful misconduct or other wrongful acts of such Partner . . . ." As found by the trial court, Fish's and Rutan's potential liability to Bobarykin and/or SupraCarbonic was based on Fish's willful misconduct while a partner at Rutan.

Of course, section 9.8 (an amendment added several years after section 10.7) also addresses indemnity for terminated partners. Under section 9.8(a) of the partnership agreement, "the Partnership shall indemnify, defend, and hold harmless any 'Covered Partner' identified in Section 9.8(b) from and against any and all claims, damages, losses, liabilities, civil fines and penalties, costs, and attorney's fees arising out of any of the 'Covered Acts' identified in Section 9.8(c)." Assuming, for the sake of argument, that Fish is correct that he is a "Covered Partner" under section 9.8(b) of the partnership agreement, the attorney fees and costs must still arise out of a "Covered Act" as defined in section 9.8(c).

A "Covered Act" under section 9.8(c) includes: "(i) a Covered Partner's acts or omissions in the provision of professional services (as an attorney, expert witness, arbitrator, mediator, or other authorized function) in the course and scope of his/her performance as a Partner of the Partnership . . . ." However, "the Partnership shall not be obligated to indemnify, defend, or hold harmless a Covered Partner if the Executive Committee makes any of the following good faith determinations, in which event the act

or omission in question shall not be considered to be a 'Covered Act' within the meaning of this Section 9.8: . . . (ii) that the Covered Partner was not acting within the course and scope of his/her performance as a Partner of the Partnership; (iii) that the Covered Partner was acting in bad faith or in reckless disregard of the best interests of the Partnership; (iv) that the Covered Partner's acts or omissions constitute willful misconduct, willful criminal wrongdoing, or willful violation of the applicable rules and regulations that govern the conduct of the members of the legal profession; (v) that the act or omission of the Covered Partner giving rise to the claim constitutes a material violation of either this Partnership Agreement or adopted firm policy. . . . The Executive Committee's good faith determination as to whether the act of omission of a Covered Partner is a Covered Act shall be final."

Here, the record is unclear precisely how Rutan determined it would not pay to defend Fish from the Bobarykin/SupraCarbonic lawsuit. It appears Rutan, in rejecting Fish's request for indemnity and a defense, did not duly consider the end of section 9.8(c), in which the Rutan executive committee is purportedly entitled to determine "in good faith" whether one of the exceptions to "Covered Acts" applies.[2] In denying Fish's request for indemnification, Rutan determined Fish was not a "Covered Partner," but its representative (Hurlbut) could not recall discussion of "Covered Acts." Surprisingly, Rutan (both in its opposition to Fish's motion for new trial and in its respondent's brief) asserts the question of "Covered Acts" is "immaterial" or "moot." Rutan even unsuccessfully proposed that the court strike its "Covered Act" findings from the judgment to avoid the argument that this finding justified a new trial. The court sensibly declined to change its decision: "There is no need for the court to incorporate the Rutan proposed additional statement of decision, and it is rejected."

[2] Section 9.8, "Defense and Indemnification of Partners by the Partnership," is 14 pages long. Section 9.8(c) alone is four pages long.

"The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other." (Civ. Code, § 1641.) "A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties." (Civ. Code, § 1643.)

Regardless of whether the executive committee of Rutan considered and invoked the process set forth in section 9.8(c), the most reasonable way to interpret the contract as a whole is to conclude that a judicial finding of willful misconduct and material violations of the partnership agreement and firm policies precludes the classification of the claim against Fish as a "Covered Act." Rutan did not remove sections 9.7 and 10.7 from the partnership agreement when it added section 9.8. Interpreting all of the provisions together, it would be unreasonable to suggest that section 9.8(c) results in indemnity in favor of a "Covered Partner" in the face of a judicial finding of willful misconduct.

Rutan's failure to follow the precise procedures in section 9.8(c) did not result in a forfeiture of its indemnity rights. Rather, it resulted in a forfeiture of Rutan's right to argue that a decision of the Executive Committee, if taken in good faith, was final on the factual determination of whether misconduct occurred.[3] We agree with the trial court's explicit and implicit contract interpretation and factual findings on this point. Rutan is not obligated to indemnify Fish because the claims and defense costs arose out of Fish's willful misconduct and violations of firm policy.

We also reject Fish's argument that Rutan owed a duty to pay the first $500,000 of the defense of Fish pursuant to the professional liability policy. The

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[3] We need not decide whether this "good faith determination" provision would have been enforceable had Rutan followed its own contractual procedures and then asked the trial court to limit its inquiry into whether the executive committee acted in "good faith" rather than the underlying question of whether Fish committed misconduct.

indemnity rights between Rutan and Fish are governed by the partnership agreement, not the insurance policy.

Fish is Not a "Covered Partner"

Fish asserts he is entitled to indemnity because he is a "Covered Partner" under section 9.8(b) of the partnership agreement. As noted above, the key issue in applying section 9.8(b) to this case is whether the so-called "toll" on competition in section 9.8(b)(iii) is enforceable. The provision states in relevant part: "[T]he term 'Covered Partners' as used herein shall exclude the following: . . . (iii) . . . any Partner who withdraws . . . as a Partner of the Partnership prior to the final resolution, whether by final nonappealable judgment or award or settlement, of a claim arising out of a Covered Act and who continues to practice law as a sole practitioner or with a private law firm . . . within a 100-mile radius of the Partnership's primary business address at any time within two (2) years after the date such withdrawal . . . becomes effective."

Rule 1-500 of the California Rules of Professional Conduct provides: "(A) A member shall not be a party to or participate in offering or making an agreement, whether in connection with the settlement of a lawsuit or otherwise, if the agreement restricts the right of a member to practice law, except that this rule shall not prohibit such an agreement which: [¶] (1) Is part of an employment, shareholders', or partnership agreement among members provided the restrictive agreement does not survive the termination of the employment, shareholder, or partnership relationship; or [¶] (2) Requires payments to a member of the member's retirement from the practice of law; or (3) Is authorized by Business and Professions Code sections 6092.5 subdivision (i), or 6093. [¶] (B) A member shall not be a party to or participate in offering or making an agreement which precludes the reporting of a violation of these rules."

Moreover, Business and Professions Code section 16600 states: "Except as provided in this chapter, every contract by which anyone is restrained from engaging in a

lawful profession, trade, or business of any kind is to that extent void." But Business and Professions Code section 16602 provides: "(a) Any partner may, upon or in anticipation of any of the circumstances described in subdivision (b), agree that he or she will not carry on a similar business within a specified geographic area where the partnership business has been transacted, so long as any other member of the partnership, or any person deriving title to the business or its goodwill from any such other member of the partnership, carries on a like business therein. [¶] (b) Subdivision (a) applies to either of the following circumstances: [¶] (1) A dissolution of the partnership. [¶] (2) Dissociation of the partner from the partnership."

Our Supreme Court reconciled lawyers' ethical duties with the statutory right of partnerships to limit competition from former partners: "An agreement that assesses a reasonable cost against a partner who chooses to compete with his or her former partners does not restrict the practice of law. Rather, it attaches an economic consequence to a departing partner's unrestricted choice to pursue a particular kind of practice." (*Howard, supra,* 6 Cal.4th at p. 419.)

"Not every agreement between partners in restraint of competition is permitted. . . . [T]he common law 'rule of reason' should apply to evaluate the noncompetition agreement under Business and Professions Code section 16602. [Citations.] . . . '[A]t common law, a restraint against competition was valid to the extent reasonably necessary for the protection of the convenantee.'" (*Howard, supra,* 6 Cal.4th at p. 416.) Likening tolls to liquidated damage provisions, the *Howard* court explained "a partner's agreement to pay former partners, or to forego benefits otherwise due under the contract, in an amount that at the time of the agreement is reasonably calculated to compensate the firm for losses that may be caused by the withdrawing partner's competition with the firm, would be permitted." (*Id*. at p. 425.)[4]

[4] Despite Fish's insistence that we separately evaluate section 9.8(b)(iii) as a liquidated damage provision under Civil Code section 1671, subdivision (b), we decline

The issue here is whether the elimination of Fish's status as a "Covered Partner" (and therefore his indemnity rights under the partnership agreement) was a reasonable toll on competition. Jeffrey Oderman, the Rutan partner primarily responsible for drafting section 9.8(b), testified the provision was "a fair accommodation of . . . and balance between the interests of the partnership and the interests of the departing or terminating partner." Oderman identified a series of costs imposed on Rutan by departing partners: increased difficulty in collecting accounts receivable; difficulty in generating work for timekeepers (associates, paralegals, etc.) left behind by the partner; continuing to pay underutilized timekeepers left behind; loss of partner's expertise, thereby reducing firm's ability to service all client needs; cost of hiring a headhunter to replace partner; loss of management time in hiring replacement; increase in each partner's share of overhead; increase in each partner's share in paying costs of malpractice insurance, including the $500,000 self insured retention for each claim; and loss of clients (especially applicable to those partners competing with Rutan in same geographic market).

Cases disclose that some methods of "tolling" are generally allowable, subject to a factual assessment of the provision's reasonableness. To offset its expected financial losses from the withdrawal of a partner, a firm might reduce a competing partner's recovery of capital accounts and/or accounts receivable. (*Howard*, *supra*, 6 Cal.4th at pp. 412 [varying levels of "'forfeiture'" of "'rights to withdrawal benefits other than capital'"]; see also *Haight, Brown & Bonesteel v. Superior Court* (1991) 234

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to do so. Fish did not breach the Rutan partnership agreement by withdrawing from the partnership. And section 9.8(b)(iii) does not even attempt to "liquidate" damages; it allocates contractual rights and obligations based on a partner's decision to compete with Rutan within 100 miles. As *Howard* explained, it is helpful to analogize to cases analyzing liquidated damage clauses when evaluating contract provisions that impose costs on departing partners. But it is incorrect to suggest that section 9.8(b)(iii) must be evaluated separately under the rule of reason and under Civil Code section 1671, subdivision (b).

Cal.App.3d 963, 966-967 [loss of ordinary rights of departing partners, including interest in capital accounts and accounts receivable] (*Haight*).) Or a firm might derive a formula requiring ongoing payments by the withdrawing partner to the firm, such as 25 percent of revenues obtained from firm clients for 24 months after the partner's departure. (See *Anderson, McPharlin & Connors v. Yee* (2005) 135 Cal.App.4th 129, 131-132 [holding such an arrangement did not violate ethical rules] (*Anderson*).)[5]

It is also clear that some provisions would be unreasonable in the context of law firms: "We consider it obvious that an absolute ban on competition with the partnership would be per se unreasonable, and inconsistent with the legitimate concerns of assuring client choice of counsel and assuring attorneys of the right to practice their profession." (*Howard*, *supra*, 6 Cal.4th at p. 425.) Extrapolating from this conclusion, it must also be true that a provision crafted to include "tolls" so expensive as to eliminate the possibility that a rational partner would choose to compete would be unreasonable.

Reported California decisions do not specifically address whether a provision like that used in this case is "reasonable" and therefore enforceable. Section 9.8(b)(iii) of the partnership agreement is far from an absolute ban on competition. Indeed, if neither the departing partner nor Rutan were sued for the acts or omissions of the departing partner, the provision would have no monetary effect. It is extremely difficult to assess the value of this provision to either an individual partner or Rutan at the

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[5] Both *Haight* and *Anderson* contemplate the consideration of evidence pertaining to the actual amount of money lost by the partner, rather than limiting consideration to whether the provision was reasonable at its inception. (*Haight*, *supra*, 234 Cal.App.3d at p. 970 fn. 9; *Anderson*, *supra*, 135 Cal.App.4th at p. 132.) Moreover, *Howard*, *supra*, 6 Cal.4th 409 did not specify whether trial courts should consider both ex ante and ex post evidence pertaining to reasonableness. Thus, the court did not err by admitting evidence of the costs imposed on Fish by section 9.8(b)(iii) compared with the benefits that accrued to Fish by departing Rutan. Like a liquidated damages analysis (Civ. Code, § 1671, subd. (b)), the focus of the inquiry should be on the reasonableness of the provision at the time of agreement. But we find no fault with the trial court's consideration of evidence of how the provision actually worked in practice.

time of contracting. The value of the provision is somewhat easier to assess at the time the partner considers leaving; if the partner is involved in litigation or expects a lawsuit, some cost-benefit analysis might be possible. We agree with the testimony of Oderman, who observed the provision "is a very light toll" when viewed at the time of signing the partnership agreement. Given the trial court's findings, we ignore Fish's self-serving testimony that he never would have joined Rutan had he actually read and/or understood the toll provision.

On the other hand, compared to the contract provisions analyzed in the cases above, there is an attenuated link between section 9.8(b)(iii) and the economic loss suffered by a law firm *as a result of losing clients and therefore revenues* to the departing partner. The toll provision of the Rutan partnership agreement does not attempt to formulaically recapture lost revenues taken by departing partners who opt to compete with Rutan. It applies to any departing partner who practices within 100 miles regardless of the number of clients taken from Rutan. Fish objects that the toll provision is not designed to extract a *proportional* tax on the firm's losses from the departing partner's competition, i.e., a toll "reasonably calculated to compensate the firm for losses that may be caused by the withdrawing partner's competition with the firm." (*Howard*, *supra*, 6 Cal.4th at p. 425.)

Having framed the contours of the question, we now must answer it directly: is the toll provision reasonable? Yes.

Partnerships are, by definition, voluntary associations formed to share the risks and rewards of a business enterprise. The Rutan partnership agreement, in painstaking detail, sets forth how the partners have opted to allocate risk with regard to a partner who is sued for acts or omissions committed while practicing at Rutan. The expressed intention of the partnership agreement is to indemnify the "Covered Acts" of *some* partners who are no longer contributing economically to the firm (retired partners,

partners practicing more than 100 miles away). But Rutan makes an exception for those partners who opt to compete with Rutan in its geographic market.[6]

The readily-apparent justification for this discrimination is that partners who decide to redirect the rewards of their practice to themselves (by leaving and continuing to practice law) *and* away from Rutan (by competing within 100 miles) should not be entitled to the benefit of risk-pooling with the remainder of the Rutan partners for any missteps or alleged missteps committed by the departing partner while practicing at Rutan. Given that Fish would no longer be around to help offset claims against other Rutan partners, but would instead be reducing Rutan's profits by making money elsewhere, this is a reasonable provision when viewed ex ante, that is, as of the time Fish agreed to the provision by joining Rutan. Viewed ex post, the provision is reasonable in that, according to the court's unchallenged findings, Fish earned substantially more by leaving Rutan than he suffered in attorney fees to defend professional liability claims.

Flotsam and Jetsam

The remainder of Fish's contentions merit only cursory analysis. First, Fish incorrectly claims he can use his *settlement* with Bobarykin as a sword to collaterally estop Rutan from claiming Fish is not entitled to indemnity under the partnership agreement. There are three fundamental problems with Fish's theory: there was no prior judgment on the merits, the issues in the two disputes are not identical, and the party against whom preclusion is being sought (Rutan) was not a party involved in the

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[6] Interestingly, section 9.8(b)(i) also excludes from the definition of "Covered Partner" those partners expelled "for cause." It is important to note that the partnership agreement does not call for the removal of partners as "Insured" parties pursuant to Rutan's professional insurance coverage (for their years of practice at Rutan). Instead, it shifts the costs of covering deductibles (specifically, a self-insured retention of $500,000 per claim) back to the partner from Rutan.

settlement. (See *Lucido v. Superior Court* (1990) 51 Cal.3d 335, 341.) We reject Fish's collateral estoppel argument.

Second, even assuming the court committed error in finding Fish established an attorney-client relationship directly with Bobarykin, any such error would be harmless because Fish's misconduct occurred regardless of whether he represented Bobarykin as an individual rather than Bobarykin as the living representative of (and 50 percent owner in) SupraCarbonic.

Third and finally, Rutan did not need to introduce expert evidence to support a finding of misconduct by Fish. The court's factual findings were based on evidence of outrageous intentional misconduct by Fish, not evidence Fish negligently represented SupraCarbonic.

DISPOSITION

The judgment is affirmed. Rutan shall recover its costs incurred on appeal.

IKOLA, J.

WE CONCUR:

RYLAARSDAM, ACTING P. J.

FYBEL, J.